Benson & Hedges (Canada) Inc.

ANNUAL REPORT 1979

Contents

Benson & Hedges (Canada) Inc. manufactures cigarettes, including Belvedere, Belvedere Extra Milds, Mark Ten, Mark Ten Lights, Benson & Hedges 100's, Benson & Hedges 100's Lights, Benson & Hedges Lights King Size, Viscount, Viscount No. 1 Ultra Light and Belmont Milds, as well as fine cut tobacco. The corporate office is located in Montreal; eight branch sales offices are located throughout the country; and manufacturing facilities are located in Montreal, Quebec and Brampton, Ontario. The Company's stemmery operation is located in Delhi, Ontario.

Review of the Year

Consolidated gross sales revenue for the Company in 1979 rose to $193,278,000 from $186,304,000 in 1978. Cigarette sales were 7.7 billion units in 1979, and the Company's share of the market was 11.8%.

Net earnings for the year were $4,352,000 compared with $5,716,000 in 1978. An industry-wide price increase in February 1979, the first for more than one year, was not sufficient to offset increases in product costs and operating expenses. These cost increases resulted from the Company's continuing commitment to upgrading overall product quality together with the impact of inflation. No dividend was declared or paid to shareholders in 1979.

On April 24, 1979, the Company's name was changed to Benson & Hedges (Canada) Inc., coinciding with the date upon which the Company was continued by registration under the Canada Business Corporations Act.

Marketing

Throughout 1979, the major participants in the Canadian cigarette industry continued to concentrate their marketing activities on products competing in the mild segment of the market. As a result of these efforts and an evident evolution of consumer preference for milder products, this segment of the market represented the source of volume growth for the total industry.

Following an analysis of industry sales trends, a need was identified for product innovation in the low delivery segment. In recognition of this need, the Company launched Benson & Hedges 100's Lights and Mark Ten Lights. These two brands provided incremental sales volume and were instrumental in achieving growth for the Benson & Hedges and Mark Ten brand families. In addition, the strong sales performance recorded by Belvedere Extra Milds contributed to an improved result for the Belvedere brand family.

The marketing programmes instituted during the year led to sales volume stability for the Company and succeeded in establishing light line extensions for the major brand families in the milder segment of the market thereby providing a base for future growth.

Operations

The efficient manufacture of the highest quality products continues to be the Company's primary operating objective. In pursuit of this objective, significant progress was made during the year in increasing productivity and in further upgrading product quality in both of the Company's manufacturing facilities located in Brampton and Montreal.

Research and Development activities received high priority and were concentrated on the development of superior quality mild products. A substantial commitment was made for the construction of a new tobacco processing facility in Brampton, Ontario.

Leaf

During the summer of 1979, the tobacco crop in the Province of Ontario suffered from the effects of a severe outbreak of blue mould. Losses caused by this disease substantially reduced the amount of tobacco harvested from a planned crop size of 230 million pounds to approximately 150 million pounds. Domestic manufacturers' requirements were substantially met. However, export sales were significantly reduced in spite of the continued support of the four Canadian cigarette manufacturers in the form of subsidies on these sales.

The Company's leaf stemmery, located in Delhi, Ontario, continued to meet the established quality and efficiency standards. The facility also processed, under contract, tobacco purchased by export dealers.

Smoking and Health

Through contributions to the Canadian Tobacco Manufacturers' Council, the Company again supported independent medical research in relation to smoking and health questions. Anti-smoking activity persisted throughout the year and a number of municipalities passed legislation prohibiting smoking in public places or the advertising of cigarette products on public transit vehicles.

The Company believes that the subject of public smoking can best be handled through common courtesy and consideration, not legislation. A program containing information on the subject was produced and shown to employees and trade groups during the year to increase the understanding of this controversy.

On behalf of the Board of Directors, I would like to take this opportunity to thank each and every member of the Company for their support and hard work during the year. I feel confident that a continuation of the dedicated efforts witnessed in 1979 will result in improvements in the Company's sales performance and operating efficiency in the years ahead.

William H. Webb

William H. Webb
President

Consolidated Balance Sheet as at December 31, 1979

Benson & Hedges (Canada) Inc.

Assets	1979	1978
Current Assets		
Short-term deposit	$ —	$ 11,494,000
Notes receivable - current portion	1,678,000	1,738,000
Accounts receivable - trade (note 2)	16,117,000	19,231,000
- other	1,724,000	1,908,000
- affiliates	82,000	533,000
Income taxes recoverable	—	1,464,000
Inventories (note 3)	55,212,000	53,416,000
Prepaid expenses	541,000	540,000
Total current assets	75,354,000	90,324,000
Notes Receivable - less current portion	14,176,000	15,874,000
Fixed Assets (note 4)		
Land, buildings and equipment - at cost	40,005,000	37,707,000
Accumulated depreciation	17,333,000	15,128,000
	22,672,000	22,579,000
	$112,202,000	$128,777,000

Liabilities	1979	1978
Current Liabilities		
Bank indebtedness	$ 10,472,000	$ 27,880,000
Notes payable	21,312,000	24,803,000
Accounts payable and accrued liabilities	12,760,000	12,950,000
Accounts payable - affiliates	—	144,000
Income taxes	358,000	—
Total current liabilities	44,902,000	65,777,000
Deferred Income Taxes	5,667,000	5,377,000
	50,569,000	71,154,000
Shareholders' Equity		
Capital Stock (note 5)		
Authorized -		
An unlimited number of common shares		
Issued and fully paid - 4,577,085 shares	22,134,000	22,134,000
Retained Earnings	39,499,000	35,489,000
	61,633,000	57,623,000
	$112,202,000	$128,777,000

Signed on Behalf of the Board

William H. Webb

Director

Oscar Guinea

Director

Consolidated Statement of Earnings

Benson & Hedges (Canada) Inc.
For the Year Ended December 31, 1979

	1979	1978
Sales	**$193,278,000**	$186,304,000
Less: Excise and sales taxes	**100,198,000**	99,235,000
	93,080,000	87,069,000
Costs		
Manufacturing, distributing, selling, general and administrative	**83,838,000**	74,892,000
Depreciation	**2,284,000**	2,175,000
Interest - net	**1,473,000**	1,602,000
Unrealized exchange gain on U.S. term deposit	**—**	(248,000)
Realized exchange gain on U.S. term deposit	**(203,000)**	—
	87,392,000	78,421,000
Earnings Before Income Taxes	**5,688,000**	8,648,000
Provision for Income Taxes		
Current	**1,046,000**	928,000
Deferred	**290,000**	2,004,000
	1,336,000	2,932,000
Net Earnings for the Year	**$ 4,352,000**	$ 5,716,000

Consolidated Statement of Retained Earnings

Benson & Hedges (Canada) Inc.
For the Year Ended December 31, 1979

	1979	1978
Balance - Beginning of Year	**$ 35,489,000**	$ 30,046,000
Net earnings for the year	**4,352,000**	5,716,000
	39,841,000	35,762,000
Refundable dividend tax (note 11)	**342,000**	273,000
Balance - End of Year	**$ 39,499,000**	$ 35,489,000

Consolidated Statement of Changes in Financial Position

Benson & Hedges (Canada) Inc.
For the Year Ended December 31, 1979

	1979	1978
Source of Working Capital		
Net earnings for the year	**$ 4,352,000**	$ 5,716,000
Items not affecting working capital -		
Depreciation	**2,284,000**	2,175,000
Deferred income taxes	**290,000**	2,004,000
Provided from operations	**6,926,000**	9,895,000
Disposal of fixed assets	**475,000**	548,000
Notes receivable	**1,698,000**	1,709,000
Source of working capital	**9,099,000**	12,152,000
Use of Working Capital		
Additions to fixed assets	**2,852,000**	2,751,000
Refundable dividend tax	**342,000**	273,000
Use of working capital	**3,194,000**	3,024,000
Increase in Working Capital	**5,905,000**	9,128,000
Working Capital - Beginning of Year	**24,547,000**	15,419,000
Working Capital - End of Year	**$30,452,000**	$24,547,000

Notes to Consolidated Financial Statements

Benson & Hedges (Canada) Inc.
For the Year Ended December 31, 1979

1. Summary of Accounting Policies

The significant accounting policies followed by Benson & Hedges (Canada) Inc. and subsidiary company are presented below to assist the reader in reviewing the consolidated financial statements and other data contained in this report. These policies comply with generally accepted accounting principles and have been consistently applied.

Consolidation -
The consolidated financial statements include the accounts of the company and its wholly-owned subsidiary B & H Retail Limited.

Receivables -
Current earnings are charged and an allowance is credited with a provision for doubtful accounts based on experience and on any unusual circumstances which may affect the ability of customers to meet their obligations. Accounts deemed uncollectible are charged against this allowance. Receivables are reported on the balance sheet net of such accumulated allowances.

Inventories -
Inventories are valued at the lower of cost and net realizable value. The cost of leaf tobacco is determined on an average cost basis and the cost of other inventories is determined generally on a first in, first out basis. It is generally recognized industry practice to classify the total amount of leaf tobacco as a current asset although part of such inventory, because of the duration of the aging process, ordinarily would not be utilized within one year.

Fixed assets -
Maintenance and repairs are charged against income and expenditures for renewals and improvements are capitalized. Provision for depreciation of assets is recorded by a charge against income at rates, which are considered adequate to amortize the cost of such assets over their useful lives using the straight-line method of computation. The useful lives assumed are as follows:

Assets	**Useful lives**
Land improvements	10 years
Buildings and building equipment	10 - 40 years
Machinery and equipment	5 - 15 years
Furniture, fixtures and data processing equipment	3 - 10 years
Transportation equipment	4 years
Leasehold improvements	Term of lease

Notes to Consolidated Financial Statements

Benson & Hedges (Canada) Inc.
For the Year Ended December 31, 1979

1. Summary of Accounting Policies (cont'd)

Income taxes -

The provision for income taxes is calculated separately on reported pre-tax earnings for the parent company and its subsidiary. Certain items of income and expense included in the financial statements, such as depreciation, are claimed in different years for tax purposes in accordance with applicable income tax laws. The resulting difference between the financial statement income tax provision and income taxes currently payable is reported in the financial statements as deferred income taxes.

Foreign exchange -

Foreign currency balances receivable and payable have been translated into Canadian dollars at the rates of exchange prevailing on the balance sheet date.

Pension plans -

The company and its subsidiary have pension plans covering substantially all of their employees. Prior service costs are amortized over periods of up to fifteen years and accrued pension costs are funded with independent trustees.

2. Accounts Receivable

Accounts receivable include trade receivables of $16,639,000 in 1979 and $19,885,000 in 1978 offset by allowances for doubtful accounts and for sales discounts of $522,000 in 1979 and $654,000 in 1978.

3. Inventories

Inventory components are as follows:

	1979	1978
Leaf tobacco	$40,259,000	$39,852,000
Packaging and other raw materials	2,838,000	2,247,000
Work in process	363,000	464,000
Finished goods	9,899,000	9,137,000
Machine parts and supplies	1,853,000	1,716,000
Total inventories	$55,212,000	$53,416,000

4. Fixed Assets

	1979			1978		
	Cost	Accumulated depreciation	Net	Cost	Accumulated depreciation	Net
Land	$ 828,000	$ —	$ 828,000	$ 828,000	$ —	$ 828,000
Land improvements	155,000	71,000	84,000	109,000	60,000	49,000
Buildings and building equipment	8,961,000	3,691,000	5,270,000	8,630,000	3,361,000	5,269,000
Machinery and equipment	25,383,000	11,806,000	13,577,000	22,827,000	10,122,000	12,705,000
Furniture, fixtures and data processing equipment	1,833,000	1,063,000	770,000	1,645,000	851,000	794,000
Transportation equipment	361,000	192,000	169,000	610,000	274,000	336,000
Leasehold improvements	695,000	510,000	185,000	652,000	460,000	192,000
Construction and machinery installation in progress	1,789,000	—	1,789,000	2,406,000	—	2,406,000
	$40,005,000	$17,333,000	$22,672,000	$37,707,000	$15,128,000	$22,579,000

The provision for depreciation included in the statement of earnings for 1979 and 1978 is $2,284,000 and $2,175,000 respectively computed on the straight-line method.

5. Capital Stock

Effective April 24, 1979, the company obtained a Certificate of Continuance under the Canada Business Corporations Act. This certificate removed the limit of the maximum number of shares that the corporation is authorized to issue.

6. Rental Expense

Total rental expense included in the statement of earnings for the years ended December 31, 1979 and December 31, 1978 was $1,325,000 and $1,062,000 respectively.

The minimum rental commitments under all non-cancellable leases for each of the five years ending December 31 are as follows:

1980 $847,000   1981 $369,000   1982 $43,000   1983 $6,000   1984 Nil

7. Research and Development Expense

Total research and development expense included in the statement of earnings for the years ended December 31, 1979 and December 31, 1978 was $534,000 and $345,000 respectively.

Notes to Consolidated Financial Statements

Benson & Hedges (Canada) Inc.
For the Year Ended December 31, 1979

8. Contingent Liabilities

During 1974, the company instituted legal action against a supplier to recover the cost of defective materials delivered in prior years to the Formosa Spring Brewery Division in the amount of $536,000. This action is being defended by the supplier and the supplier has made a counter claim for damages in the amount of $1,507,000. This claim has been denied and with the advice of counsel, is being vigorously contested. Accordingly, no provision or adjustment has been made in the financial statements.

9. Pension and Retirement Plan

Pension plan expense included in the statement of earnings for the years ended December 31, 1979 and 1978 was $849,000 and $645,000 respectively. Included in expense for 1979 and 1978 is the amortization of the unfunded liability of $302,000 and $240,000 respectively of which $71,000 and $17,000 respectively pertain to the amortization of prior years' past service cost. The unfunded liability outstanding was estimated to be $730,000 as at December 31, 1979, and $322,000 as at December 31, 1978.

Included in the unfunded liability is an unfunded past service pension liability of $655,000. This liability is being funded by equal annual installments of $71,000 to December 31, 1989 and $59,000 thereafter to 1993.

10. Commitments

As at December 31, 1979, the company has made financial commitments of $2,246,000 for purchases of equipment and $6,657,000 for purchases of inventories.

11. Refundable Dividend Tax

Certain taxes paid by the company on investment income are refundable to the company at the rate of $1 for every $4 of taxable dividends paid to shareholders. The current year's refundable tax and the cumulative refundable amount as at December 31, 1979 were $342,000 and $615,000 respectively. Such tax and its recovery is charged and credited to retained earnings.

Auditors' Report to the Shareholders

We have examined the consolidated balance sheet of Benson & Hedges (Canada) Inc. as at December 31, 1979 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion these consolidated financial statements present fairly the financial position of the company as at December 31, 1979 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Coopers & Lybrand

Coopers & Lybrand
Chartered Accountants

January 7, 1980

Five Year Summary

(Canadian $,000 omitted)

	1979	1978	1977	1976	1975
Sales	**$193,278**	$186,304	$196,371	$214,487	$200,398
Earnings Before Income Taxes and Extraordinary Items	**$ 5,688**	$ 8,648	$ 9,858	$ 12,438	$ 15,007
Net Earnings	**$ 4,352**	$ 5,716	$ 6,572	$ 6,742	$ 8,429
Capital Expenditures	**$ 2,852**	$ 2,751	$ 3,726	$ 4,621	$ 5,062
Working Capital	**$ 30,452**	$ 24,547	$ 15,419	$ 11,888	$ 15,519
Shareholders' Equity	**$ 61,633**	$ 57,623	$ 52,180	$ 47,603	$ 40,861
After-Tax Return on Shareholders' Equity	**7.3%**	10.4%	13.2%	15.2%	23.0%
Sales Units (Billions of Cigarettes)	**7.700**	7.613	8.262	9.066	8.703
Number of Employees	**1,142**	1,093	1,149	1,288	1,301

Directors and Officers

Directors

Hamish Maxwell
President & Chief Executive Officer
Philip Morris International

Geoffrey Bible
Vice President
Philip Morris International

John B. Claxton, Q.C.
Partner
Lafleur, Brown, De Grandpré

R. William Murray
President
Philip Morris Europe, S.A.

Oscar Y. Primeau
Vice President
Benson & Hedges (Canada) Inc.

The Hon. Maurice Sauvé, P.C.
Executive Vice President,
Administrative and Public Affairs
Consolidated Bathurst Inc.

Colin B. Scarfe
President
Seven-Up Canada Limited

William Stevenson
President
Millbrook Industries Limited

William H. Webb
President
Benson & Hedges (Canada) Inc.

Officers

Hamish Maxwell
Chairman of the Board

William H. Webb
President

John J. O'Brien
Vice President Marketing

Oscar Y. Primeau
Vice President Corporate Relations

Derek L. Smith
Vice President Finance & Administration
Treasurer

Udo R. Westphal
Vice President Operations

Dennis Robertson
Controller

Kenneth Erlick
Secretary

Auditors

Coopers & Lybrand

Bankers

The Royal Bank of Canada
The Bank of Montreal

Legal Counsel

Lafleur, Brown, de Grandpré
Miller, Thomson, Sedgewick,
Lewis & Healy